SUPREME COURT OF FLORIDA

CASE NO.: 65,118

DIXIE NATIONAL BANK OF DADE COUNTY, etc.,

Plaintiff,

v.

EMPLOYERS COMMERCIAL UNION INSURANCE COMPANY OF AMERICA, etc.,

Defendant-Third Party Plaintiff-Appellant,

v.

DR. THOMAS F. CARNEY, etc., et al.,

Third Party Defendants-Appellees.

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ON CERTIFIED QUESTIONS FROM THE UNITED STATES COURT OF APPEALS, ELEVENTH CIRCUIT, ON APPEAL FROM THE UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF FLORIDA

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STATEMENT OF THE CASE AND FACTS

This cause is before the Supreme Court of Florida upon certified questions presented to it by the United States Court of Appeals for the Eleventh Circuit pursuant to §25.031, Florida Statutes and Rule 9.150, Florida Rules of Appellate Procedure.

The certified questions presented herein arise from an appeal by Employers Commercial Union Insurance Company of America which seeks to reverse the summary judgment dismissal of its third party claims against the board of directors of Dixie National Bank of Dade County and American Home Assurance Company by the United States District Court for the Southern District of Florida.

In this Answer Brief, Employers Commercial Union Insurance Company of America will be referred to as "appellant" or "Employers"; Dixie National Bank of Dade County will be referred to as "Dixie National Bank" or "Bank"; the directors of Dixie National Bank will be referred to as "the directors"; American Home Assurance Company will be referred to as "American Home"; and the directors and American Home will be collectively referred to as "appellees". Record-on-Appeal references herein will be designated "R".

In April of 1975, Dixie National Bank commenced this litigation against Employers in the United States District Court, Southern District of Florida, for the purpose of recovering

against Employers upon a banker's blanket bond policy of insurance with respect to an embezzlement loss of approximately $246,000.00 resulting from defalcations of Dixie National's former Cashier (R 4-6).

During June of 1975, and after filing an Answer denying liability to Dixie National, Employers filed a Third Party Complaint against Dixie National's directors for their alleged negligent performance of duties to "manage and direct the affairs of the bank with care and prudence" and to "properly supervise the affairs of the bank and its officers" (R 31-34). Employers' Third Party Complaint relied solely upon theories of equitable subrogation (R 36, 106-107). Subsequently, in February of 1976, Employers filed a "Third Party Plaintiff's First Amended Complaint" against the directors which also relied upon equitable subrogation theories (R 114-116, 187-188). Indeed, in response to a motion of the appellee directors to dismiss Employers' "First Amended Third Party Complaint", Employers specifically admitted that according to Florida law, as an insurer, its subrogation rights arose from and were founded upon operation of law rather than being dependent upon contractual assignments of rights:

> Defendant Third Party Plaintiff [Employers] would contend that the law is too well established to need citation that a surety has subrogation rights when stepping into the shoes of someone else in paying or having to pay a loss. Obviously, the right to subrogation arises because of the relationship between the Defendant/Third Party Plaintiff

> and the Plaintiff and because of operation of law. Consequently, there is no oral agreement or written contract necessary for Defendant/Third Party Plaintiff to acquire its rights in this cause since the rights of Defendant/Third Party Plaintiff arise by way of subrogation. . . . (R 187-188).

Employers filed yet another Complaint - a "Second Amended Third Party Complaint" - against the directors in March, 1976. This Complaint again relied upon theories of equitable subrogation (R 208-211,304-306). In its reply to a motion of the appellee directors to dismiss the Second Amended Third Party Complaint, Employers yet again expressly recognized that equitable principles governed and controlled its claims:

> Legal subrogation does not depend on a contract but arises out of equitable considerations. . . . Under the rule, Employers will be subrogated to the bank's cause of action for negligence against the Directors, upon payment of the bank's loss, if Employers is entitled to such subrogation in equity. The instant case presents facts resulting in equitable considerations shifting . . . in Employers' favor (R 305).

During or about June of 1976, after withholding payment from Dixie National Bank for over one and a half years (R 1, 5-6), Employers finally paid Dixie National approximately the principal amount of its embezzlement claim, and as a condition of such payment extracted an assignment from the Bank which provided:

> By the execution of this Agreement Dixie National Bank of Dade County does hereby set over, assign, transfer and convey all of its right, title and interest in and to any claims which it may have against all parties

> which may have caused, directly or indirectly, any of the losses set forth in the Complaint . . . now pending in the United States District Court for the Southern District of Florida (R 769-773).

Then, in August, 1976, Employers filed a "Third Amended Third Party Complaint" which joined appellee American Home as an additional third party defendant in its capacity as an insurer under a directors liability and corporate reimbursement insurance policy (R 410-413). This Complaint likewise proceeded solely upon theories of equitable subrogation by operation of law and did not assert a claim against either Dixie National's directors or American Home based upon the written assignment of rights which it had previously obtained from Dixie National (R 410-413).

The appellee directors and American Home filed a Motion for Judgment on the Pleadings on May 1, 1981, based primarily upon the leading case of <u>First National Bank of Columbus v. Hansen</u>, 267 N.W.2d 367 (Wis. 1978), which is directly on point with and factually identical to the instant case (R 762-768).

Recognizing that the <u>First National Bank of Columbus</u> case unequivocally rejected negligence claims of the nature asserted by it against the directors based upon equitable subrogation, on May 11, 1981 - ten days after appellees had filed their Motion for Judgment on the Pleadings - Employers filed a "Supplemental Third Party Complaint" which sought to evade the impact of <u>First National Bank of Columbus</u> by adding claim allegations to the effect that it was also belatedly relying upon

the assignment which Dixie National Bank had given it approximately five years earlier (R 769-773).

The federal district court subsequently treated appellees' Motion for Judgment on the Pleadings as one for summary judgment and entered a partial summary judgment against Employers on the issue of director negligence (R 823). In a detailed and well-reasoned partial summary judgment order, the district court concluded that Florida law is in conformity with the holdings in First National Bank of Columbus and determined that "[b]ecause Employers, a compensated surety, cannot establish equities superior to those of the Directors, the Court adopts the rule in [First National Bank of Columbus v.] Hansen and holds that no right of subrogation exists in favor of a fidelity insurer against its insured's Directors for ordinary negligence in the conduct of their supervisory duties" (R 819). In response to Employers' attempt to improve its position by its assertion of Dixie National Bank's assignment of claims, the Court also held:

> By supplementing its pleadings to reflect the Bank's assignment of claims, Employers now contends that its capacity to sue is derived not only from a status as an equitable subrogee, but also as a contractual recipient of the claims; therefore, Employers need not show superior equities to assert its contractual right of action. This argument emphasizes form to the detriment of substance. . . . [and notwithstanding the assignment, subrogation will be] enforced only in favor of a meritorious claim, and after a balancing of the equities [as engaged in the First National Bank of Columbus decision] (R 820-821).

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The Court further concluded, however, that Employers would be entitled to subrogation "upon proof of culpability by the third party defendants in the nature of fraud or bad faith", also in conformity with First National Bank of Columbus (R 822).

Thereafter, the parties executed a Pre-Trial Stipulation and a set of "Stipulated and Disputed Facts" for the purpose of resolving the remaining possible issue perceived by the Court of whether the appellee directors could conceivably be found guilty of conduct amounting to bad faith or fraud (R 871-878, 901-906). Based upon the undisputed facts contained in the Pre-Trial Stipulation and "Stipulated and Disputed Facts", the district court subsequently entered a clarifying order in which it concluded that no evidence existed that the directors committed fraud or acted in bad faith. Accordingly, the district court entered a final summary judgment against Employers (R 921-930). Employers thereupon instituted an appeal to the United States Court of Appeals, Eleventh Circuit. (R 931).

While Employers contended on appeal to the Eleventh Circuit that disputed evidence exists, this contention was limited to an argument that "there is disputed evidence . . . that the Directors were negligent in failing to adequately perform" their alleged duties. Employers has acknowledged that it "has not challenged the conclusion in the clarifying order [of the federal district court] that its proof does not establish actual knowledge of the embezzlement, dishonest purpose or

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furtive design. Employers [instead] contend[s] (and the Court below did not hold otherwise) that its evidence of fault is . . . sufficient to go to a jury on the issue of the Directors' liability under standards of proof generally recognized in cases . . . for negligence" (Employer's Brief of Appellant filed with the Eleventh Circuit at pp. 7-8).

Following the filing of briefs on the merits by the parties and oral argument before the Eleventh Circuit Court of Appeals, that Court certified questions of Florida law that are determinative of this cause to this Court.

CERTIFIED QUESTIONS

POINT I

IN AN ACTION BY A FIDELITY BOND INSURER AGAINST THE DIRECTORS OF A BANK AND THE DIRECTORS' INSURER FOR THE DIRECTORS' NEGLIGENCE IN FAILING TO PREVENT EMBEZZLEMENT LOSSES, IF THE FIDELITY BOND INSURER OBTAINS RIGHTS AGAINST THE INSURED'S DIRECTORS THROUGH LEGAL OR EQUITABLE SUBROGATION AND ALSO OBTAINS A WRITTEN ASSIGNMENT OF CLAIMS FROM THE BANK, DOES FLORIDA LAW REQUIRE THE FIDELITY INSURER TO ESTABLISH SUPERIOR EQUITIES AS BETWEEN THE FIDELITY INSURER AND THE DIRECTORS AND THEIR INSURER IN ORDER TO RECOVER?

POINT II

IF SO, DOES THE FIDELITY INSURER'S STATUS AS A PAID SURETY ESTABLISH SUPERIOR EQUITIES IN FAVOR OF THE INSURED'S DIRECTORS AND THE DIRECTORS' INSURER WHERE THE FIDELITY INSURER MERELY ASSERTS THE DIRECTORS' NEGLIGENCE AS THE BASIS FOR RECOVERY?

ARGUMENT

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A. Employers' Subrogation Claims Are Subject to Equitable Considerations According to Florida Law

It is well settled in Florida that subrogation is an equitable doctrine, and the availability of a subrogation remedy depends on the relative equities of the matter and not on inflexible or technical rules of "law". Dantzler Lumber & Export Co. v. Columbia Casualty Co., 156 So. 116 (Fla. 1934); American Home Assurance Co. v. City of Opa Locka, 368 So.2d 416 (Fla. 3d DCA 1979). Accord American Fidelity & Casualty Co. v. United States Fidelity & Guaranty Co., 305 F.2d 633 (5th Cir. 1962). A claimant is entitled to invoke subrogation only when justice demands its application to the particular facts and circumstances of a given case. See Dantzler, supra, at 119.

A critical requirement of successfully asserting an action for subrogation is that the claimant affirmatively establish superior equities in himself vis-a-vis the party

against whom subrogation is sought to be enforced. See Ruwitch v. First National Bank of Miami, 291 So.2d 650 (Fla. 3d DCA 1974), cert. denied 305 So.2d 196 (Fla. 1974); 83 C.J.S. Subrogation Section 54. The United States Fifth Circuit Court of Appeals succinctly articulated this threshold requirement in Compania Anonima Venezolana de Navegacion v. A.J. Perez Export Co., 303 F.2d 692 (5th Cir. 1962), observing that subrogation is not an absolute right, but rather is one which depends on the equities of the facts and circumstances of the particular case:

> [T]he equity of the party seeking subrogation must be strong and his rights clear, and his equity must be superior to that of other claimants. . . . And it 'will not be enforced to the prejudice of other rights of equal or higher rank. . . .' Subrogation 'is not an absolute right . . . but rather, a matter of grace to be granted or withheld as the equities of the case may demand'.

303 F.2d at 697.

Indeed, in prior pleadings filed by Employers in the instant case, it has unequivocally conceded that, as a surety for hire, its rights arise by operation of equitable subrogation law and that its claims must rise or fall upon the establishment by it of superior equities.

> Defendant Third Party Plaintiff [Employers] would contend that the law is too well established to need citation that a surety has subrogation rights when stepping into the shoes of someone else in paying or having to pay a loss. Obviously, the right to subrogation arises because of the relationship between the Defendant/Third Party Plaintiff and the Plaintiff and because of operation of law. Consequently, there is no oral agree-

ment or written contract necessary for Defendant/Third Party Plaintiff to acquire its rights in this cause since the rights of Defendant/Third Party Plaintiff arise by way of subrogation. . . . (R 187-188). (emphasis added).

Legal subrogation does not depend on a contract but arises out of equitable considerations. . . . Under the rule, Employers will be subrogated to the bank's cause of action for negligence against the Directors, upon payment of the bank's loss, if Employers is entitled to such subrogation in equity. The instant case presents facts resulting in equitable considerations shifting . . . in Employers' favor (R 305) (emphasis added).

B. Under Florida Law, Employers Cannot Avoid the Requirement that it Establish Superior Equities Merely by Obtaining a Written Assignment from Dixie National Bank

Employers attempts to totally circumvent established subrogation requisites by simplistically asserting that it is a "conventional" or contractual subrogee in addition to being an equitable subrogee by virtue of the assignment which it belatedly extracted from Dixie National Bank. According to Employers' argument, it need not establish superior equities in order to assert a "conventional" right of subrogation. However, as the district court found, Employers' argument ". . . emphasizes form to the detriment of substance", and must be rejected (R 820).

Employers' argument in the district court as well as in its Initial Brief of Appellant improperly confuses the significance of Dixie National Bank's assignment to it. While a distinction exists in the law as between "legal" subrogation and "conventional" subrogation, it has been properly held that any

distinction between them is significant only in determining the source of the right of subrogation, and not in delineating the parameters of the remedy available to the assignee party. As explained by the Supreme Court of Florida in Boley v. Daniel, 72 So. 644 (Fla. 1916), subrogation arises by operation of law where one having a liability or a right or a fiduciary relation in the premises pays a debt due by another under such circumstances that he is entitled to the obligation held by the creditor whom he has paid, whereas conventional subrogation occurs when one having no interest in or relation to a matter pays the debt of another and by contractual agreement is granted the rights of the creditor so paid. See 72 So.2d at 645. This distinction is important only in determining, in the first instance, the "standing" of the party asserting the right of subrogation. For example, if one who has no legal or other obligation pays a debt of another, he is deemed to be a "volunteer", who has no right to subrogation to the rights of the other by operation of law. E.g. Boley v. Daniel, supra, and Norfolk & Dedham Fire Ins. Co. v. Aetna Cas. & Sur. Co., 318 A.2d 659 (Vt. 1974). For this reason, courts will recognize the contractual assignment by a damaged party of his rights against third parties. By acquiring such contractual rights, the subrogated party is no longer a mere volunteer without a remedy against such third parties, but rather is a "conventional" subrogee who gains standing to assert a subrogation claim.

According to the best-reasoned of authorities, while a "conventional" subrogee obtains standing to assert a subrogation claim which he would otherwise lack, "conventional" subrogation merely allows him to stand in the same shoes as those who are subrogees by operation of law, and he must, therefore, meet the same equitable requirements that the courts impose on such subrogees in order to recover. Bank of Fort Mill v. Lawyers Title Ins. Corp., 268 F.2d 313 (4th Cir. 1959); American Ins. Co. v. City of Milwaukee, 187 N.W.2d 142 (Wis. 1971). See also Associated Hospital Service v. Pustilnik, 396 A.2d 1332 (Pa. App. 1979); Castleman Construction Co. v. Pennington, 432 S.W.2d 669 (Tenn. 1968); Roberts v. Fireman's Ins. Co., 101 A.2d 744 (Pa. 1954); United States Fid. & Guar. co. v. First Nat. Bank in Dallas, 172 F.2d 258 (5th Cir. 1949).

Any other result in the case of an insurer such as Employers would make a mockery of the well-reasoned and deeply embedded principles that underlie the doctrine of subrogation by allowing the insurer to do indirectly what the law prohibits him from doing directly.

American Insurance Co. v. City of Milwaukee, is particularly apt. In that case, an insurance company attempted to engage in the identical ploy attempted by Employers in the instant case. Other insurance companies had previously brought claims against the same target defendant on the same factual circumstances upon theories of "legal" subrogation, and those

previous claims had been dismissed upon equitable principles applicable to subrogation actions. The insurance company thereupon obtained an assignment from its insured and then argued that its subrogation claims should not be similarly dismissed because it was also relying on the assignment. In rejecting the insurance company's attempts to circumvent established subrogation law, the Court observed:

> [T]his case is almost a re-run of the appeal involving other insurance carriers similarly situated and the [defendant].
>
> What is different is that the insurer sought reimbursement from the [defendant] as subrogees. Now they seek such reimbursement as assignees. They have changed costumes. Where earlier they appeared in the garments of equity-seeking subrogees, they return clad in the armorplate of assignees. Their claim, with which the trial court agreed, is that the change in attire entitles them to receive at law exactly what they were denied in equity. However, what was intended as a change in role, on analysis turns out to be not more than change in outer dress, leaving unchanged their role, their rights and the result.
>
> This second time around appears based upon an assumption that subrogation is subrogation, entirely a creature of equity, and assignment is assignment, entirely a consequence of contract, and never the twain shall meet. The fault with such 'either-or' over-simplification is that it ignores the fact that there are two types of subrogation.

187 N.W.2d at 144.

The American Ins. Co. court went on to explain and hold that the reasoning and outcome of subrogation must be the same,

regardless of whether the plaintiff asserts its claim on the same operative facts as a "legal" subrogee or as a "conventional" one:

> Subrogation is recognized or denied upon equitable principles, without differentiation between 'legal subrogation', arising by application of equity, or 'conventional subrogation', arising from contracts or acts of the parties.

187 N.W.2d at 145.

Bank of Fort Mill v. Lawyers Title Ins. Corp., supra, is also directly on point. In that case, just as in this one, a paid insurer attempted to avoid its inability to overcome the requirement of establishing superior equities from defeating its subrogation claim against a bank by arguing that it occupied a different position from a "legal" subrogee by virtue of its having obtained an express assignment of rights from its assured. However, in a well-reasoned opinion, the court held that regardless of the source of the surety's claim to subrogation, the surety's right to recover was nonetheless governed by equitable principles: "If insurers have no right to subrogation, their position is not improved by the assignments to them of insured's claim against the Bank." Bank of Fort Mill, 268 F.2d at 315. The Court noted that according to the overwhelming weight of authority subrogation is an equitable right applicable only where the equities of the party seeking subrogation are superior to those of the party against whom the right is asserted, and held that the lower court had committed reversible error in not

balancing the equities and in finding that the surety had bettered its position by virtue of its insured's assignment.

The principles applicable herein have likewise been succinctly stated in Associated Hospital Service v. Pustilnik, supra:

> The doctrine of subrogation is based 'on considerations of equity and good conscience . . . to promote justice . . . [and] is granted as a means of placing the ultimate burden of the debt upon the person who should bear it.' It is not a matter of contract nor of privity. It 'may be invoked in favor of persons who are legally obligated to make good a loss caused by the negligent or tortious act of another.' 'It is a device adopted by equity to compel the ultimate discharge of an obligation by him who in good conscience ought to pay it'. . . . A right to subrogation may be contractually declared, but even then the right is to be based on equitable principles, since the right of subrogation exists wholly apart from the contractual provision. . . . 83 C.J.S. Subrogation § 3b ('A right of true legal subrogation may be provided for in a contract, but the exercise of the right will, nevertheless, have its basis in general principles of equity rather than in the contract, which will be treated as being merely a declaration of principles of law already existing.')

396 A.2d 1336.

Similarly, in United States Fid. & Guar. Co. v. First Nat. Bank in Dallas, supra, the United States Fifth Circuit Court of Appeals has refused to allow an insurer such as Employers to improve its position as a subrogee merely by seeking to rely upon a written assignment as a tool to evade equitable subrogation principles for the following compelling reasons:

> Since [the plaintiff insurer] expressly, voluntarily and for a compensation guaranteed against loss in the exact situation involved, the equity in the situation cannot lie in favor of [it].
>
> * * *
>
> When [the insurer] paid [its insured], it took a release of its liability and an assignment of the [insured's] claim[s] . . . The executed document first expressly releases and discharges the [insurer] from all liability . . .; then it embodies an assignment from the [insured] to [the insurer] of all of the [insured's] claims against other parties. It is self-evident that when the [insurer] paid the [insured] there remained in existence no enforceable claim by the [insured] against [a defendant] bank which the [insured] could assign to the [insurer].
>
> * * *
>
> Appellant [insurer] had no right of subrogation as against the [defendant] bank, nor did it acquire by the assignment any cause of action against it.

172 F.2d at 264.

Employers cannot side step the requisite elements of a claim for subrogation and thereby gain greater rights than the law permits merely by extracting an assignment from its insured. When Employers paid Dixie National Bank the sums due under its claim for dishonest acts, it attained all of the rights the law accords a surety to claims against third persons, and its position was neither improved nor lessened by virtue of the assignment from Dixie National. The trial court so found, and its decision should not be overturned by this Court.

In its Initial Brief of Appellant, Employers primarily relies upon the cases of Dispatch Services Inc. v. Airport Bank of Miami, 266 So.2d 127 (Fla. 3d DCA 1972), and First National Bank of Atlanta v. American Surety Co., 30 S.E.2d 402 (Ga. App. 1944), in support of its argument that the district court erred in holding that equitable subrogation principles apply to its subrogation claims regardless of whether Employers attempted to improve its position by belatedly seeking to assert "conventional" subrogation. Employers' reliance upon these cases is misplaced.

Dispatch Services is not dispositive of the instant dispute, nor was it binding on the district court. The district court judge thoroughly considered Dispatch in entering judgment against Employers and properly concluded that it should not be interpreted as allowing Employers to arbitrarily improve its position as a subrogee in this case by virtue of its assignment. (R 821). In Dispatch, a surety of a bank depositor brought a subrogation action against the bank for wrongful payment of a check upon an assignment of the depositor's right against the bank. The bank therein had cashed forged checks drawn upon the depositor's account, acts for which the law holds a bank absolutely liable.

The District Court in the instant case concluded:

> In reaching its decision, the [Dispatch] court relied upon the well-established principle that a bank is absolutely liable to its depositor for payment on a forged check. Clearly strong policy considerations shifted the balance of the equities and mandated the

result in Dispatch, and not a per se rule precluding equitable considerations from conventional subrogation claims. (R 821.)

Of equal import, a fundamental distinction exists with respect to the nature of the relationships between the parties in Dispatch and those in the instant case. The plaintiff in Dispatch was the insurer of a bank's customer, rather than an insurer of the bank itself, and it sought recovery against the bank. In the instant case, Employers is the insurer of the bank and is seeking to sue the bank's board of directors.

A special relationship exists between a corporation and its board of directors. It is axiomatic that a corporation can only act through its directors and that the corporation is managed by its directors. Litigation on behalf of a corporation constitutes the business and affairs of the corporation and the power to control such litigation cannot be completely divested from its directors. See Burks v. Lasker, 441 U.S. 471 (1979); Zapata v. Maldonado, 430 A.2d 779 (Del. 1981); Gaines v. Haughton, 645 F.2d 761 (9th Cir. 1981); Genzer v. Cunningham, 498 F.Supp. 682 (E.D. Mich. 1980); Auerbach v. Bennett, 47 N.Y.2d 619 (393 N.E.2d 994, 419 N.Y.S.2d 920 (1979); Joy v. North, 692 F.2d 880 (2d Cir. 1982), cert. denied 103 S.Ct. 1498 (1983); United Copper Securities Co. v. Amalgamated Copper Co., 244 U.S. 261 (1917); Gall v. Exxon Corporation, 418 F.Supp. 508 (S.D. N.Y. 1976). Thus, claims by a corporation against its directors are not freely fungible, unlike other ordinary causes of action,

because such claims are an inherent matter of corporate governance.[1]

Moreover, if held liable to Employers, the directors would in turn have a claim for indemnification from the bank for their losses (12 C.F.R. 7.5217; see also §607.014, Fla. Stat. (1977). The statutory and regulatory provisions regarding indemnification demonstrate the specious nature of Employers' assertion that by suing the directors it is not suing its own "insured", the bank. In reality, the bank may find itself bearing all or a portion of the economic burden caused by Employers' litigation against the directors, and, indeed, under certain circumstances may be required to do so. (Ibid.) Insofar as the bank in turn may seek reimbursement from American Home under the Directors and Officers Liability and Corporation Reimbursement Policy, it should be noted that the insurance policy requires the insured to bear the amount of the policy's retention.[2] In the last analysis, however, countenancing this type of suit by a surety will adversely affect banks by

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1 Neither National Union nor the directors have ever conceded in this litigation that the assignment given by Dixie National Bank to Employers was intended to encompass claims against them as opposed to claims against the defalcating employee.

2 Generally speaking, directors and officers liability and corporation reimbursement also require coinsurance. See J.W. Bishop, The Law of Corporate Officers and Directors ¶8.01 (1981); Knepper, Liability of Corporate Officers and Directors §20.13 (3d ed. 1978). In the particular instance of the policy issued to Dixie National Bank, coinsurance was waived pursuant to Endorsement No. 5.

dissuading them from pressing fidelity claims against sureties for fear of subsequent retaliatory measures by sureties against their directors.

The rationale of First Nat. Bank of Atlanta v. American Surety Co., supra, which the Dispatch court referred to in its opinion is simply not reflective of Florida law. In that case, a Georgia appellate court held that its decision to allow an insurer of a bank depositor to recover against a bank on forged checks that it had cashed was controlled by Georgia Statutes and Code Sections which it interpreted as evidencing an intention by the Georgia Legislature to alter, replace and supersede traditional equitable subrogation with its own statutory subrogation scheme.

While the Georgia Legislature may have chosen to extinguish the requirement of establishing superior equities by statute, as held in First National Bank of Atlanta, the Florida Legislature has not done so and no precedent exists in Florida common-law which would support the Georgia decision as a correct rule of law in Florida.[3]

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3 Additionally, in Bank of Fort Mill, the United States Fourth Circuit Court of Appeals severely criticized First Nat. Bank of Atlanta for the same reasons that the Fifth Circuit Court of Appeals had earlier held that an assignment cannot be utilized to improve an insurer's posture in United States Fid. & Guar. Co., supra. In Bank of Fort Mill, the Fourth Circuit observed that First Nat. Bank of Atlanta appears to be based upon the premise that under Georgia law an
(Cont'd next page)

Florida courts have long recognized and applied the equitable subrogation principles which _First National Bank of Columbus v. Hansen_ relied upon in denying recovery to fidelity insurers who have occupied the identical position as Employers herein. E.g. _Ruwitch v. First National Bank of Miami_, _supra_. Indeed, even Employers has recognized in its previous pleadings in this case that "equitable considerations" govern its subrogation claim (R 106, 305).

Even assuming, _arguendo_, that the Florida appellate court's decision in _Dispatch_ could be interpreted as holding that equitable considerations must be abandoned in "conventional" subrogation cases (thereby replacing substance with form), such a holding would be contrary to fundamental Florida law as expressed by the Supreme Court of Florida and other Florida courts.

The Supreme Court of Florida long ago defined and limited the distinction between equitable and conventional subrogation as being significant only in determining the _source_ of the right to subrogation:

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assignment converts an equitable right to a legal right and thereby precludes a court from applying equitable principles. It then concluded that any such reasoning would be fallacious because:

> [I]f insurers have no right to subrogation, their position is not improved by the assignment to them of an insurer's claim against [a] Bank. (Citing United States Fid. & Guar. Co. v. First National Bank, 172 F.2d 258 (5th Cir. 1949); American Surety Co. v. Bank of California, 133 F.2d 160 (9th Cir. 1943)).

Bank of Fort Mill, 268 F.2d at 316.

> Subrogation arises by operation of law where one, having a liability or a right or a fiduciary relation in the premises, pays a debt due by another under such circumstances that he is in equity entitled to the security or obligation held by the creditor whom he has paid. This is called 'legal subrogation'. 'Conventional subrogation' depends upon a lawful contract, and occurs where one, having no interest in or relation to the matter, pays the debt of another, and by agreement is entitled to the securities and rights of the creditor so paid.

Boley v. Daniel, 72 So. at 645.

As admitted by Employers in its prior pleadings (R 106, 187-188), it is also firmly settled in Florida that an insurer such as Employers obtains subrogation rights by operation of law upon payment of an insured loss whether or not its policy provides for subrogation and whether or not the insured has formally assigned its rights against any alleged wrongdoers to the insurer. Atlantic Coast Line R. Co. v. Campbell, 139 So.886 (Fla. 1932); Scott v. Rosenthal, 118 So.2d 555 (Fla. 3d DCA 1960); 31 Fla.Jur.2d, Insurance, §949.

In fact, in Atlantic Coast Line R. Co. v. Campbell, the Florida Supreme Court expressly held that equitable subrogation principles form the very foundation of an insurer's right to recovery:

> [An] insurer's right of recovery rests upon the very nature of the contract of insurance as a contract of indemnity . . . and . . . it rests upon the equitable doctrine of subrogation by operation of law, whether any special agreement to assign the cause of action was made by the injured party with the assured or not.

139 So. at p. 889 (emphasis added).

The principle that the essence of an insurer's subrogation rights are equitable in nature, as recognized and accepted by the Florida Supreme Court in Atlantic Coast Line, is the very same principle relied upon by the courts in Castleman Construction Co. v. Pennington, supra, Associated Hospital Service v. Pustilnik, supra, and Bank of Fort Mill v. Lawyers Title Ins. Corp., supra, in determining that equitable considerations utilized in "legal" subrogation are also applicable to "conventional" subrogation.

As held in the Associated Hospital Service decision:

> A right to subrogation may be contractually declared, but even then the right is to be regarded as based on equitable principles, since the right of subrogation exists wholly apart from the contractual provision.

396 A.2d at p. 1336 (emphasis added).

As similarly determined in the Castleman Construction Co. case:

> The doctrine of subrogation in insurance does not arise from, nor is it dependent upon, statute or custom or any of the terms of the contract; it has its origin in general principles of equity and in the nature of the insurance contract as one of indemnity. The right of subrogation rests not upon a contract, but upon the principles of natural justice.
>
> * * *
>
> [R]egardless of the source of the right of subrogation [i.e. 'legal' subrogation or

> 'conventional' subrogation], the right will only be enforced in favor of a meritorious claim and after a balancing of the equities.
>
> * * *
>
> Subrogation rests upon purely equitable grounds, and it will not be enforced against superior equities.

432 S.W.2d at 675-676.

The same definition was relied upon in the Castleman Construction Co. case, supra, in determining that equitable considerations govern the outcome of "conventional" subrogation as well as "legal" subrogation cases:

> We would agree with the complainants that the authorities do make a distinction between legal and conventional subrogation. However, in essentially all the authorities which we have read the distinction is made in determining whether there is a right of subrogation in the first instance, rather than in the enforcement of such right. In other words, the distinction is made in determining the source of the right rather than in applying the remedy.

432 S.W. at 675 (emphasis added).

The Supreme Court of Florida's position that the distinction between "legal" and "conventional" subrogation is significant in determining whether a right of subrogation exists in the first instance, and its recognition that an insurer's right to recovery is based upon equitable subrogation principles, compels the conclusion that under Florida law equitable considerations cannot be cavalierly abandoned as urged by Employers merely because an insurer such as it seeks to re-cast

its case as a "conventional subrogation" one by extracting an assignment of rights from its insured.

According to Florida law, a fidelity insurer must establish superior equities in actions for conventional subrogation based on assignments, as well as in actions brought for equitable subrogation by operation of law. Accordingly, the first certified question presented to this Court by the federal Eleventh Circuit Court of Appeals should be answered "Yes".

POINT II

THE FIDELITY INSURER'S STATUS AS A PAID SURETY ESTABLISHES SUPERIOR EQUITIES IN FAVOR OF THE INSURED'S DIRECTORS AND THE DIRECTORS' INSURER WHERE THE FIDELITY INSURER MERELY ASSERTS THE DIRECTORS' NEGLIGENCE AS A BASIS FOR RECOVERY.

The record in the instant case conclusively shows that appellant Employers does not have superior equities as against the appellees. Where a fidelity insurer, as a paid surety, merely sues directors of a bank for negligence as a basis of recovery, the fidelity insurer fails to establish superior equities.

When it issued (and was paid for) its fidelity bond, Employers specifically undertook to insure the Bank against embezzlement in return for considerable premium payments. It now seeks to render its obligation under the bond meaningless by, in effect, recovering back against the Bank through members of the Bank's board of directors. Employers has admitted, as it must,

that the appellee directors did not embezzle any funds, did not have knowledge of the embezzlements, did not participate in the concealment of any wrongful act, did not act for dishonest purposes or furtive designs, and did not gain or stand to gain from the embezzlements (AB 5, 8; R 875, 902). In actuality, the directors, charged with the overall responsibility for Dixie National Bank's operations, were equally if not more aggrieved by the wrongful acts of the embezzler than was Employers.

The leading case of First National Bank of Columbus v. Hansen, 267 N.W.2d 367 (Wis. 1978), relied on by the district court, is factually identical with, and dispositive of, the instant case. In Hansen, a bank sued two bonding companies to recover on fidelity bonds insuring against the dishonest acts of bank employees. The bonding companies instituted third-party subrogation actions against the Bank's board of directors, alleging that the directors were negligent in failing to take steps to prevent the embezzlement by a bank employee which gave rise to the suit.[4] The directors' motion for summary judgment was granted on the ground that no recognizable subrogation claim existed in favor of the bonding companies.

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4 The allegations of negligence against the directors in Hansen included a failure to exercise proper supervision over the defalcating employee and a failure to thoroughly audit the affairs of the bank. See Hansen, supra, at 369 n.3. The same allegations of negligence form the basis of the present action against the directors of Dixie National Bank.

In affirming the summary judgment, the Supreme Court of Wisconsin initially noted that it is widely recognized that a fidelity insurer may be subrogated to an insured bank's rights against the defaulting employee and against negligent third-parties, but that no court had yet considered whether a subrogation action could be maintained by such an insurer against its own insured's board of directors for alleged ordinary negligence in the conduct of their supervisory duties. The Court then held that the balance of equities precluded the bonding companies' subrogation action against the directors:

> [T]he existence of a claim in favor of a bank against its officers and directors is not conclusive of the right of a fidelity insurer to be subrogated to that claim. A fidelity insurer will not be subrogated to the rights of its insured unless the equities in favor of the fidelity insurer are greater than those of the person against whom subrogation is invoked. Liberty Mut. Ins. Co. v. Kleinman, 149 Cal. App.2d 404, 308 P.2d 347, 348 (1957); see generally, Annot. 95 A.L.R. 271 (1935). We hold that the balance of equities in this case will not permit the fidelity insurer to be subrogated to the insured's claim of negligence against its own directors.

Hansen, 267 N.W. 2d at 371.

In its position as Dixie National Bank's fidelity insurer, Employers cannot assert, via a subrogation action, the directors' negligence as a basis for recouping payment to the Bank on its bond since any such alleged negligence is and should be deemed to be one of the very risks assumed by Employers pursuant to its insurance agreement.

A fundamental principle of insurance law is that a fidelity insurer cannot avoid liability on a bond by asserting that its insured negligently caused the loss. See, e.g., First National Bank of Fort Walton Beach v. United States Fidelity and Guaranty Co., 416 F.2d 52 (5th Cir. 1969). Closely on point is Fidelity & Deposit Co. v. Courtney, 186 U.S. 342 (1902), in which the United States Supreme Court rejected a bonding company's defense to an action by an insured bank for payment on a fidelity bond based on the alleged failure of the bank's board of directors to properly supervise a dishonest bank executive. The Supreme Court reasoned as follows:

> It is well settled that in the absence of express agreement, the surety of a bond given to a corporation, as a condition for the faithful performance of an employee of his duties, is not relieved from liability for a loss within the condition of the bond by reason of the laches or neglect of the board of directors, not amounting to fraud or bad faith. . . .

Fidelity, 186 U.S. at 360.

See also Mutual Loan & Building Assoc. v. Price, 16 Fla. 204 (1877). Cf. Miami Nat. Bank v. Pennsylvania Ins. Co., 315 F.Supp. 858 (S.D. Fla. 1970).

In First National Bank of Columbus v. Hansen, supra, the Wisconsin Supreme Court correctly concluded that a fidelity insurer such as appellant Employers should not only be barred from asserting the negligence of its own insured bank as a defense to its liability to the bank on a fidelity bond, but should

also be precluded from asserting such negligence as a basis for subrogation recovery against the insured's directors:

> Though the bonding companies do not here assert the negligence of . . . directors as a defense to liability upon the bond, the fact that the negligence of the bank's agents is a risk assumed by the fidelity insurer in exchange for the premium also enters into the balance of equities in determining whether a right of subrogation is appropriate. The bonding companies have assumed the risk of that negligence which is imputable to the bank, and we conclude, therefore, that the bonding companies may not avoid that risk simply by paying on the bond and suing these officers and directors as individuals thereafter.

267 N.W. 2d at 372.

In ruling against the fidelity bond insurers, the Hansen court also held that the judicial system is not bound by any rigid "legal" rules which might result in a bank's directors being considered as separate entities from the bank itself when they are treated by insurers as targets for subrogation claims. It, instead, properly concluded that the courts can take notice that a bank qua a bank can only operate through the actions of its board of directors and determined that the directors are the bank for subrogation purposes:

> We think the equitable principles which deny an insurer the right of subrogation against its own insured are also applicable here. In this case, the negligence of the bank in permitting Hansen's wrongful acts to go undiscovered is but the negligence of its officers and directors whose duty is to supervise the operations of the bank. Since the bonding companies have no claim based on negligence against the bank, we hold that

> equity will not permit the fidelity insurer to avoid that result by suing the officers and directors individually.

Hansen, 267 N.W.2d at 372.

The concept in Hansen that directors should be considered inseparable from an insured corporation with respect to fidelity bonds is far from unique. For example, in connection with the termination clause of such a bond, knowledge of the directors of a dishonest act by an employee covered by the bond constitutes knowledge of the insured and thus terminates the bond as to the dishonest employee. Fidelity & Deposit Co. v. Courtney, 186 U.S. 341 (1902); First National Bank of Sikeston v. Transamerica Ins. Co., 514 F.2d 981 (8th Cir. 1975); Central Progressive Bank v. Fireman's Fund Ins. Co., 658 F.2d 377 (5th Cir. 1981). Similarly, dishonest acts by directors can be imputed to and constitute dishonest acts by the insured corporation itself and thus the insured may be estopped from recovering under the fidelity bond. See Levey v. Jamison, 82 F.2d 958 (4th Cir. 1936); Couch on Insurance 2nd §46:232 (1982); Appleman, Insurance Law and Practice, §5678 (1981).[5]

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5 In its Initial Brief of Appellee, Employers has cited exclusion 2(d) of the policy, which excludes the acts of the directors from coverage under the bond, to somehow justify its assertion that the instant litigation does not run afoul of the rule prohibiting an insurance company from suing its own insured. Employers does not point out, however, that the directors' acts are excluded from the coverage afforded to the bank under the bond in order to prevent the bank from
(Cont'd next page)

In its Initial Brief of Appellant, Employers does not and cannot deny that the Hansen case is virtually identical to the instant one. Instead, it argues that Florida law does not follow Hansen under a balancing of the equities test. This argument is contradicted by the many Florida cases which utilize the balancing of equities in subrogation cases, including the case of Ruwitch v. First National Bank of Miami, supra. In Ruwitch, subrogation recovery was denied to a surety that insured losses of a bank due to forgery for the same reasons that recovery was denied in Hansen and by a balancing of the equities:

> The question presented is whether or not INA [the bank's insurer] by virtue of its right to subrogation is entitled to judgment. . . . We think this should be answered in the negative.
>
> INA was a surety for hire by the Bank and the equitable maxim 'sureties are favored in the law' has no application to a company in the business of suretyship for hire. . . . As such a surety, INA received premium payments from the Bank, and in turn agreed to insure the Bank upon the occurrence of certain specific risks, such as forgery.

In 83 C.J.S. Subrogation §54, it is stated:

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making claim under the bond for the acts of its directors, who are the bank, as distinguished from the acts of the bank's employees.

As discussed above, in numerous contexts, courts have recognized that the directors are inseparable from the bank in situations involving fidelity bonds.

> 'The right to recover from a third person is conditional on whether or not the right of the one seeking subrogation is superior to the equities of those against whom the right is sought to be enforced, in contrast to the right to recover from the principal, which is absolute.' See also 50 Am.Jur. Subrogation §111.

Ruwitch, 291 So.2d at 653.

In this regard, the case of Manufacturer's Bank v. Transamerica Ins. Co., 568 F.Supp. 790 (E.D. Mo. 1983), relied upon by Employers, should not be given any weight by this Court because it arbitrarily takes the position that an insurer should always be subrogated to the rights of its insureds as against other parties. In doing so it ignores the fundamental principle that each subrogation claim must be considered on an individual basis and that courts must balance the equities in granting or denying subrogation in each case. By taking such a position, the Manufacturer's Bank case also ignores the Ruwitch v. First National Bank of Miami case, holding that a balancing of the equities is particularly applicable to fidelity insurers who are paid to assume the risk of forgeries and embezzlements.

Any alleged doubt of Employers as to how a denial of recovery by it against the directors and American Home can be legally justified is also totally dispelled by the Ruwitch decision. In Ruwitch, the court refused to allow subrogation recovery to the surety on the following rationale:

> In our view, the equities of INA are not superior to [defendants] who were acting as guarantors. . . . The liability of the

> [defendants] is predicated on their contract of guaranty; INA's liability to the Bank arose out of the specific provision of the policy covering forgery. Both parties were secondarily liable for the actions of [the forger] as they affected the bank.

291 So.2d at 653 (emphasis added).

Here, the facts are even more compelling in favor of both the directors and American Home than in Ruwitch because the directors never guaranteed the acts of a defalcating employee. It is axiomatic that directors are not guarantors of acts of a bank's employees. Briggs v. Spaulding, 141 U.S. 132 (1891). Moreover, American Home can at most be secondarily liable for the acts of the directors solely by virtue of its contractual obligations as an insurer. Thus, in accordance with Ruwitch's holdings, under no circumstances can it be found that Employers' rights are superior to the equities of either the directors or of American Home as required in order for Employers to be entitled to a judgment against them herein.

Just as in Hansen, the balance of the equities in the instant case precludes Employers from being subrogated to any claim the Bank may have had against its directors. The injustice that would result from allowing Employers' actions is clear: any insurance company undertaking to indemnify an insured under a fidelity bond could nullify its bargained-for obligation by suing the insured's board of directors for negligently permitting the very act for which insurance is sought. As recognized in Hansen,

the courts should not intervene to produce such unfair and unintended consequences.[6]

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6 In effect, Employers seeks to make the directors co-sureties with it on its bond. Article 7.5215 of the Interpretive Rulings of the Comptroller of the Currency explicitly states, however, that "[D]irectors should not serve as sureties on such bonds". (R 874-875.)

CONCLUSION

The federal district court properly held that Employers' attempt to evade equitable considerations by belatedly asserting that it is a "conventional" subrogee was without merit. The district court also properly determined that the equitable principles applicable to subrogation claims require that Employers not be allowed to nullify its bargained-for obligation to insure against risks assumed by it through the ploy of suing its insured's board of directors. Accordingly, both of the questions certified to this Court should be answered in the affirmative.

Respectfully submitted,

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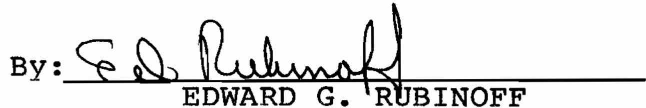

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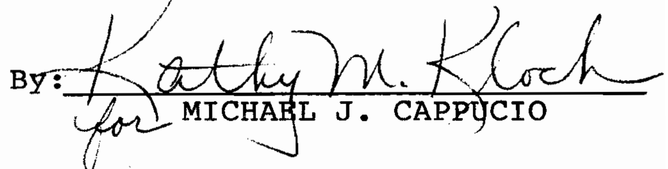
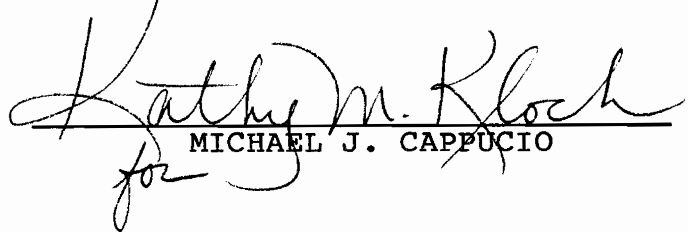


By: for MICHAEL J. CAPPUCIO

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Answer Brief of Appellees was mailed to JAMES E. TRIBBLE, ESQ., Blackwell, Walker, Gray, Powers, Flick & Hoehl, Attorneys for Appellant, 2400 AmeriFirst Building, Miami, Florida 33131 on this 15th day of June, 1984.



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